THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. SUPERIOR COURT

Docket No. 03-E-0106

In the Matter of the Liquidation of
The Home Insurance Company

RESPONSE OF CENTURY INDEMNITY COMPANY TO LIQUIDATOR'S SUR-REPLY AND IN FURTHER SUPPORT OF MOTION TO LIFT STAY AND TO COMPEL ARBITRATION

Century Indemnity Company ("CIC"), by its attorneys, Morrison & Foerster LLP and Orr & Reno, P.A., respectfully submits this memorandum of law in response to the Liquidator's Sur-reply in Opposition to CIC's Motion to Lift Stay and to Compel Arbitration (the "Sur-reply") and in further support of CIC's motion.

A. The Breach of Utmost Good Faith that CIC Seeks to Arbitrate Arises Because of Home's Collusion with its Cedents, Not Because of Home's Insolvency.

The Liquidator's attempt to refashion CIC's claim of breach of contract into an insolvency issue fails for a number of reasons. First, Home's duty of utmost good faith is unaffected by Home's insolvency. The Liquidator's admission that "[t]he only provision [in the Insurance and Reinsurance Agreement] that addresses liquidation is the insolvency clause" (Sur-reply at 2, n.1) proves the point: the substance of this provision is mandated by the Liquidation Statute (RSA 402-36) "regardless of whether the reinsurance contract provides...that in the event of the insolvency of the ceding insurer, the reinsurance shall be payable by the assuming insurer on the basis of the claims allowed...without diminution because of the insolvency of the ceding insurer." There is no similar statute that overrides the duty of utmost good faith in the event of insolvency, nor does the Insurance and Reinsurance Agreement so provide. The absence of any alteration in the parties' mutual obligation of utmost good faith – either by statute, regulation or

agreement – demonstrates that it survived Home's insolvency intact. As in *Northwestern Mut. Fire Ass'n v. Union Mut. Fire Ins. Co of Providence, R.I.*, 144 F.2d 274, 276 (9th Cir.), Home, and the Liquidator who stands in Home's shoes, "is required to exercise the utmost good faith in all its dealings with" CIC.

Second, CIC's claim of breach arises because the Liquidator decided to increase the assets of Home's estate by colluding with the AFIA cedents and encouraging them to file claims. This collusive behavior may have been prompted by Home's insolvency, but is not unique to insolvency: instead, the issue arises every time a cedent colludes with a policyholder. *See, e.g., Commercial Union Insurance Co. v. Seven Provinces Insurance Co., Ltd.*, 9 F. Supp. 2d 49 (D. Mass. 1998) (holding that a reinsurer must cover settlements entered into by the ceding insurer so long as the settlements are not fraudulent, *collusive*, or made in bad faith).[1] The Liquidator thus cannot hide behind the cloak of insolvency to defend against CIC's claim.

Third, at bottom, the Liquidator argues that New Hampshire's insolvency law permits him to disregard his contractual obligations – at his discretion – whenever it might increase the value of the insolvent estate. That is not the law in New Hampshire or anywhere else. CIC is thus entitled to arbitrate Home's breach of the Insurance and Reinsurance Agreement.

B. The Liquidator's Argument Regarding CIC's Reservation of Rights Is Irrelevant to this Motion

The Sur-reply insists that CIC's repeated reservation of rights do not bar the application of res judicata. This claim, however, is entirely irrelevant on this motion, because res judicata,

---

[1] In *Lexington Ins. Co. v. Multinacional de Seguros S.A.*, Case No: 2000 Folio 198, [2008] EWHC 1170 (Royal Courts of Justice, Queen's Bench Div. Comm) (¶ 167), the English court concluded that it was a breach of the cooperation clause of the reinsurance agreement for the cedent "in contraction of the strategy previously agreed...to write a letter which asserted the legal incorrectness of the time bar point in a manner which was likely to encourage, or provide support for" the claimant to pursue its claim against the cedent. There is a cooperation clause in the Insurance and Reinsurance Agreement (Ex. A, ¶ 5). In the arbitration, CIC will rely on this and other express provisions to prove that Home breached the duty of utmost good faith.

collateral estoppel and laches are each issues that must be decided by the arbitration panel, not by a court. *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002).

C. ***Howsam*** **Controls Here**

The Liquidator's attack on *Howsam*'s applicability fails for three reasons. First, although this issue has not been decided by New Hampshire courts after *Howsam,* CIC never argued that waiver by litigation conduct should be decided by the arbitrators. *See* CIC Reply at 29 and n.13 (citing *Marie v. Allied Home Mortg. Corp.*, 402 F.3d 1 (1st Cir. 2005)). Instead, it demonstrated that this Court should find that CIC did not waive its rights to pursue arbitration here by participating in the AFIA Litigation. As CIC explained, the Liquidator (not CIC) brought the litigation, CIC (and others) were forced to intervene in order to assert the argument that the AFIA Agreement was a statutory violation, CIC expressly and repeatedly reserved its right to assert its separate contractual defenses (defenses that must be brought in arbitration), the Liquidator early agreed to CIC's reservation of rights, and the Court approved CIC's reservation, making it an order of the court.

Second, the Liquidator's attempt to use the First Circuit's holding in *Marie* is unpersuasive because, as described above and in CIC's Reply, *Marie* addressed only the issue of waiver by litigation conduct. *Howsam* and its progeny provide the appropriate framework for resolving the defenses the Liquidator has raised, requiring that arbitrators, not the court, resolve the "procedural questions which grow out of the dispute and bear on its final disposition." The affirmative defenses of res judicata, collateral estoppel, laches and the like are precisely the "procedural questions" left for the arbitrator to decide. This is particularly true in light of the expertise of industry arbitrators (as are required by the Insurance and Reinsurance Agreement here), which helps to secure a fair and expeditious resolution to the present dispute that involves

a bedrock principle in reinsurance: whether there has been a breach of the duty of utmost good faith.

Third, the Liquidator relies on two cases to suggest that the Court should decide the preclusive effect of the Approval Order. *Bryan County v. Yates Paving & Grading Co.*, 281 Ga. 361 (2006), is neither controlling nor instructive because it was decided under Georgia's arbitration act, not the FAA, and relied on an interpretation of specific language in the arbitration provision at issue, whose language is substantially narrower than the broad arbitration clause contained in the parties' Insurance and Reinsurance Agreement. The *W. Dow Hamm III v. Millenium Income Fund LLC,* 237 S.W.3rd 745, 755 and n.11 (Tex. Ct. App. 2007) case involved the res judicata effect of a prior arbitral award, yet it defeats the Liquidator's position when it acknowledged that "[t]he opinions adopting the 'prior-court-judgment exception' mainly predate *Howsam.* We do not determine what effect, if any, *Howsam* may have had on this line of authority." Casting further doubt on the viability of this pre-Howsam authority, the *W. Dow Hamm* court (like CIC) pointed out that the Eleventh Circuit in *Klay* recognized, on the basis of *Howsam,* the "abrogation of pre-Howsam authority of *Kelly v. Merrill Lynch, Pierce, Fenner & Smith,* 985 F.2d 1067 (11th Cir. 1993), in which Eleventh Circuit Court of Appeals had applied prior-court-judgment exception" to allow the court to decide the res judicata effect of its earlier decision . *W. Dow Hamm*, 237 S.W.3d at 755, n.11 (citing *Klay v. United Healthgroup, Inc.,* 376 F.3d 1092, 1109-10 (11th Cir. 2004) (emphasis added).

Howsam's direction is clear and binding on this Court. The arbitration panel should decide whether, and to what extent, CIC's contractual claims against Home are affected by Home's affirmative defenses.

CONCLUSION

WHEREFORE, for all the foregoing reasons and for all the reasons set forth in CIC's Reply and CIC's Memorandum, Century Indemnity Company respectfully requests that the Court modify the Stay Order, compel arbitration of CIC's defensive claims and grant such further relief as the Court deems just.

Dated: June 17, 2008

Respectfully submitted,

CENTURY INDEMNITY COMPANY

By its attorneys,

Gary S. Lee
Kathleen E. Schaaf
James J. DeCristofaro
Morrison & Foerster LLP
1290 Avenue of the Americas
New York, New York 10104
Telephone: (212) 468-8000

-and-

Lisa Snow Wade
ORR & RENO, Professional Association
One Eagle Square
P.O. Box 3550
Concord, New Hampshire 03302-3550
Telephone: (603) 224-2381

Certificate of Service

I hereby certify that a copy of the foregoing Response of Century Indemnity Company to Liquidator's Sur-reply and in Further Support of Motion to Lift Stay and to Compel Arbitration was sent this 17th day of June, 2008, by first class mail to all persons on the attached service list.

Lisa Snow Wade

SERVICE LIST

J. Christopher Marshall, Esq.
NH Attorney General's Office
Civil Bureau
New Hampshire Department of Justice
33 Capitol St.
Concord, NH 03301-6397

J. David Leslie, Esq.
Eric. A. Smith, Esq.
Rackemann, Sawyer & Brewster
One Financial Center
Boston, MA 02111

Peter G. Callaghan, Esq.
Preti, Flaherty, Beliveau, Pachios & Haley, PLLP
57 North Main Street
PO Box 1318
Concord, NH 03302-1318

George T. Campbell, Esq.
Robert Stein & Associates, PLLC
One Barberry Lane
P.O. Box 2159
Concord, NH 03302-2159

Jack B. Gordon, Esq.
Fried Frank Harris Shriver & Jacobson LLP
1001 Pennsylvania Avenue, NW
Washington, DC 20004-2505

David M. Spector, Esq.
Dennis G. LaGory, Esq.
Schiff Hardin LLP
6600 Sears Tower
Chicago, IL 6060
Andrew W. Serell, Esq.
Rath, Young and Pignatelli
One Capital Plaza
443746_1.DOC

P.O. Box 1500
Concord, NH 03302-1500

Stephan P. Parks, Esq.
Doreen F. Connor, Esq.
Wiggin & Nourie PA
670 North Commercial St.
Manchester, NH 03105-0808

Michael Cohen, Esq.
Cohen & Buckley, LLP
1301 York Road
Baltimore, MD 21093

Office of the Liquidation Clerk
RE: Home Insurance Liquidation
PO Box 1210
Manchester NH 03102-1210

Office of the Liquidation Clerk
RE: Home Insurance Liquidation
59 Maiden Lane, 5th floor
New York, NY 10038